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Claiming Entity Discounts in Addition to Special Use Valuation

Neil E. Harl

Iowa State University

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Robert P. Achenbach, Jr.

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Dr. Neil E. Harl, Esq.

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Claiming Entity Discounts in Addition to Special Use Valuation

-by Neil E. Harl*

With the realization that repeal of the federal estate tax and generation skipping transfer tax was unlikely for periods after 2009¹ (and that the two transfer taxes would very likely survive after 2009 without interruption) along with reintegration of the federal gift tax into the federal estate tax and with the survival of the new income tax basis at death,² came increased attention to strategies for minimizing federal estate tax for those with larger estates. One of those strategies involves the issue of eligibility of farm and ranch estates for special use valuation³ and also, in the same estate, for a discount for minority interest in the land-owning entity.

It has been clear for several years that farm and ranch estates could be eligible for a discount for minority interest⁴ or for special use valuation.⁵ The question has been whether both discounts from the gross estate could be claimed and, if so, how the discounts were to be calculated.

Litigated cases

In *Maddox v. Commissioner*,⁶ the estate made an election for special use valuation of the decedent's minority interest in the real estate which was used in a family farm. The estate then attempted to reduce the special use valuation of the decedent's interest in the real estate by 30 percent because of the decedent's minority interest.⁷ The Tax Court held that the estate could not take advantage of such a double deduction. The case was not appealed.

In a later case, *Estate of Hoover v. Commissioner*,⁸ the Tax Court held that, when an estate makes an election to value qualified real property under special use valuation,⁹ the estate foregoes the ability to employ a minority discount factor in the calculations.¹⁰ However, in *Estate of Hoover*¹¹ the decision of the Tax Court was reversed by the Tenth Circuit Court of Appeals¹² and the Internal Revenue Service later acquiesced in the appellate court decision.¹³ In the Tenth Circuit decision in *Hoover*,¹⁴ the court reasoned that the determination of fair market value "... necessarily must consider the decedent's minority interest and discount for it."¹⁵ Citing the regulations,¹⁶ the court agreed that fair market value is determined on the basis of all relevant factors including "the degree of control of the business represented by the block of stock to be valued."¹⁷ Therefore, in order to arrive at "fair market value" for a minority interest, a discount may properly be used to account

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Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.

for the lack of control and lack of marketability.¹⁸ For that reason, it was appropriate for the estate to claim a minority interest discount.

Because the difference in *Estate of Hoover v. Commissioner*¹⁹ between the fair market value (including a minority interest discount) and the decedent's pro rata share of the special use value exceeded the statutory maximum (then) of \$750,000, the estate was properly eligible also for a \$750,000 reduction from the gross estate.²⁰ Thus, the estate properly reported the fair market value for the property (which included the 30 percent minority interest discount) minus \$750,000.

Calculation procedure

For estates sufficiently large to exceed the maximum reduction of gross estate from special use valuation, the calculation procedure involves four steps –

1. Determine the value of the real property in question without a discount for a minority interest.
2. Apply the minority interest discount if the estate is eligible.
3. Calculate the decedent's percentage of the resulting "fair market value."
4. Subtract the allowable reduction from the gross estate derived from special use valuation of the property.

For those concerned about recapture of special use valuation benefits,²¹ and which property is to be subjected to the special use valuation election,²² it is necessary to determine the real estate which would yield the required reduction from the gross estate. That procedure has yet to be prescribed in regulations, rulings or in litigated cases.

Endnotes

¹ Pub. L. No. 107-16, 115 Stat. 41, 150 (2001) (repeal of federal estate tax and generation skipping transfer tax after 2009 but all provisions in that enactment were scheduled to "sunset" for "... estates of decedents dying, gifts made or generation skipping transfers after December 31, 2010."). See generally 5 Harl, *Agricultural Law* § 43.02 (2008); Harl, *Agricultural Law Manual* § 5.02 (2008).

² I.R.C. § 1014.

³ I.R.C. § 2032A. See also 5 Harl, *Agricultural Law* § 43.03 (2008); Harl, *Agricultural Law Manual* § 5.03[2] (2008).

⁴ See, e.g., *Estate of Litchfield v. Comm'r*, T.C. Memo. 2009-21 (discounts allowed for stock of S corporation owning farmland and securities for lack of marketability, lack of control and capital gains anticipated on liquidation).

⁵ E.g., *Schuneman v. United States*, 783 F.2d 694 (7th Cir. 1986), *rev'g*, 570 F. Supp. 1327 (C.D. Ill. 1983) (landowner was sufficiently "at risk" for special use valuation "qualified use" test with rent calculated as the lesser of that derived from 70 bushels of corn per acre at \$2.25 per bushel with an adjustment if the revenue from the farmland was less).

⁶ 93 T.C. 228 (1989).

⁷ *Id.* at 229-230.

⁸ 102 T.C. 777 (1994)

⁹ I.R.C. § 2032A.

¹⁰ *Estate of Hoover v. Comm'r*, 102 T.C. 777, 781 (1994).

¹¹ *Id.*

¹² *Estate of Hoover v. Comm'r*, 68 F.3d 1044 (10th Cir. 1995), *acq.* 1998-2 C.B. 254.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Treas. Reg. § 20.2031-1(b).

¹⁷ See Treas. Reg. § 20.2031-2(f).

¹⁸ *Estate of Berg v. Comm'r*, 976 F.2d 1163, 1165-66 (8th Cir. 1992) (minority interest discount applicable in determining fair market value of a 26.92 percent interest in real estate holding company).

¹⁹ 68 F.3d 1044 (10th Cir. 1995).

²⁰ I.R.C. § 2032A(a)(3).

²¹ I.R.C. § 2032A(c).

²² Treas. Reg. § 20.2032A-8(c)(4).

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